No. 68

In the Supreme Court of the United States

OCTOBER TERM, 1946

BEULAH B. CRANE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 34–45) is reported in 3 T. C. 585. The opinion of the Circuit Court of Appeals (R. 53–56) is reported in 153 F. 2d 504.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 28, 1945. (R. 57.) The petition for a writ of certiorari was filed on March 25, 1946, and granted on April 29, 1946. (R. 57–58.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer received under her husband's will an apartment house, worth about $262,000 at the time of his death and subject to a mortgage of $255,000 and accrued interest of about $7,000, so that her equity in the property was zero. For seven years she collected the rents, paid the operating expenses, interest on the mortgage, and taxes, and was allowed deductions for depreciation on the full value of the building without any reduction on account of the mortgage. At the end of that period the taxpayer sold the property, subject to the mortgage, for a net sum of $2,500.

The question presented is the amount of taxpayer's gain, which depends upon (1) the unadjusted basis of the property within the meaning of Section 113 (a) (5) of the Revenue Act of 1938 and the applicable Treasury Regulations, (2) the adjusted basis of the property within the meaning of Section 113 (b) (1) (B), and (3) the amount realized upon the sale within the meaning of Section 111 (a) and (b).

STATUTES AND REGULATIONS INVOLVED

The statutes and Regulations involved will be found in the Appendix, *infra*, pp. 35–38.

STATEMENT

The parties filed a stipulation of facts (R. 14–34) which was adopted by the Tax Court as

part of its findings of fact. (R. 35.) The stipulated facts not set forth in the Tax Court's findings were expressly included by reference. The findings of the Tax Court (R. 35–38) may be summarized as follows:

The taxpayer was the sole legatee and devisee of her husband, who died on January 11, 1932, and was also the executrix of his estate. The decedent owned an apartment house, which at the time of his death was subject to a mortgage in the amount of $255,000, and on which there was due accrued interest in the amount of $7,042.50, so that the total lien on the property was $262,042.50. For the purpose of the federal estate tax, the propery was appraised as of the date of decedent's death at a value of $262,042.50, the exact amount due on the mortgage. (R. 35–36.)

On February 1, 1932, and at all times thereafter until the property was sold in November, 1938, the mortgage was in default for the nonpayment of interest. (R. 36.) In the early part of 1932 the taxpayer and the mortgagee entered into an agreement whereby the taxpayer was to operate the apartment house property, collect the rents, and pay for all necessary repairs and other expenses, reserve $200 a month for the payment of taxes, and remit the balance to the mortgagee at the end of each month on account of the mortgage. (R. 36.) The *net* rentals from the premises for the years 1932 to 1938, inclusive, were paid to

the mortgagee by the taxpayer in accordance with the agreement. (R. 36.)

In 1938 when the mortgagee was about to foreclose the mortgage, the taxpayer, in order to avoid such action, entered into a contract to sell the property *subject to the mortgage* for a cash consideration of $3,000. Pursuant to the contract, the taxpayer conveyed the property on November 29, 1938, and received $3,000 in cash, out of which she paid expenses in the amount of $500. The taxpayer was not a party to the mortgage, and did not at any time assume any personal liability upon the mortgage. (R. 36–37.)

Taxpayer filed income tax returns for the estate and for herself for the years between the death of decedent and the sale of the propery, in which she reported the rentals from the apartment house as gross income, and claimed deductions for interest paid on the mortgage and for the taxes and operating expenses of the property. She claimed deductions for depreciation each year, ranging from $3,200 to $3,900, and aggregating $25,500. (R. 37.)

In her return for 1938, the taxpayer reported a capital gain of $2,500 from the sale of the apartment house property, and included one-half, or $1,250, in her income. The Commissioner determined that the taxpayer sustained a capital loss of about $500 from the sale of the land, and that she realized an ordinary gain of about $24,000

from the sale of the building. (R. 38.) The taxpayer sought a review of the Commissioner's determination in the Tax Court, which decided in favor of the taxpayer; it held that the basis of the property was zero, that no depreciation allowance could be made on such a basis, and that the gain was limited to $2,500, which represented the total "amount realized." (R. 43.) Two members of the Tax Court dissented. (R. 45.) The Commissioner appealed to the Circuit Court of Appeals, which reversed the decision of the Tax Court, with Judge Swan dissenting. (R. 53–57.)

SUMMARY OF ARGUMENT

The amount of gain realized by the taxpayer upon the sale of the apartment house which she inherited under the will of her husband is the difference between the amount realized and the adjusted basis. Accordingly, it is necessary under the statute to ascertain first the unadjusted basis, secondly, the adjusted basis, and finally the amount realized.

1. The principal controversy in regard to the unadjusted basis is whether the word "property" in the statute and Regulations means the physical thing, the apartment house, or the taxpayer's net cash interest in the apartment house. The value of the apartment house was about $262,000, whereas the taxpayer's net cash interest in it on the critical date was zero. This Court has held

that the words of a statute are to be interpreted in their usual, ordinary and everyday meaning; and that this rule applies to taxing acts. Property ordinarily connotes ownership and ownership relates to the physical thing without taking into account any liens or encumbrances. If Congress had intended to make the taxpayer's net cash interest on the date of acquistion the basis for determining gain or loss, it would have used an appropriate term like "cash interest," "equity," or "equity of redemption."

The taxpayer in this case was the sole owner of the property from the date of her husband's death, and she alone had the right to possess, use and dispose of it. She collected the rents and paid the operating expenses. She claimed and was allowed depreciation on the basis of the full value of the apartment house without any reduction on account of the mortgage. She paid interest on the mortgage while she was in possession of the property and claimed and was allowed deductions for interest just as though she were the mortgagor. She reported the rentals as gross income and claimed deductions for the operating expenses of the property. She paid taxes on the property and claimed deductions in income tax returns on that account. When she sold the property, she sold the physical property itself.

The phraseology of the Regulations and the reference in the Regulations to the federal estate

tax clearly show that the value of the physical thing, rather than the value of taxpayer's net cash interest was intended as the basis of the property.

It would be unreasonable to construe the Regulations as meaning the taxpayer's net cash interest in the property, for such a construction would introduce administrative complication and confusion.

The construction of the word "property" in the statute and the Regulations is a question of law. Therefore the court below was free to reverse the decision of the Tax Court on the ground that it had erred on questions of law.

2. The Revenue Act expressly provides for the adjustment of the basis on account of depreciation to the extent allowed, but not less than the amount allowable. That provision is merely a legislative enactment of a rule laid down by this Court, which decided that the basis would have to be adjusted on account of depreciation in order to determine gain or loss even though the statute under consideration did not expressly require it.

In this case, the land was not subject to depreciation and therefore its basis need not be adjusted. But in regard to the building the taxpayer had been allowed depreciation in the aggregate amount of $25,500, and the amount allowable could readily be computed from the unadjusted basis of the building, the stipulated rate of depreciation and

the period during which it was held by the taxpayer.

Whether the taxpayer received a tax benefit from the depreciation allowance is immaterial, because this Court has decided that even though the taxpayer does not receive a tax benefit from depreciation, the basis must be adjusted on account of depreciation.

3. In regard to the amount realized, the word "property" in the statute should be construed in the same manner that it was construed in the basis provision so that the symmetry of the Act may be preserved. If the word "property" means the physical thing, the fair market value of the real estate sold by the taxpayer was $258,000 because the purchaser bought the property subject to a mortgage of $255,000 and paid $3,000 in cash. Obviously, he could have paid off the mortgage and owned the property free and clear at a cost of $258,000. If we are right that the basis of the property included the $255,000 mortgage, it would be absurd to eliminate the mortgage from the selling price and to say that the taxpayer sold the property for $3,000 gross or $2,500 net. That would result in a loss of more than $200,000 for the taxpayer, although she concedes and the Tax Court decided that she realized a gain of $2,500. The only way in which a reasonable result could be obtained is to add the principal amount of the mortgage to the amount of cash received.

Since the parties stipulated how the selling price should be allocated between the land and the building, it is a simple matter to ascertain the gain or loss on the sale of the land and the building. The gain on the building roughly approximates the amount of depreciation accrued during the period the taxpayer held it.

While the taxpayer did not assume personal liability on the mortgage, she stood in the shoes of the mortgagor, enjoyed all the tax benefits to which the mortgagor was entitled and attempted to meet the obligations of the mortgage. Under such circumstances it is not unreasonable to treat her as though she were the mortgagor.

ARGUMENT

INTRODUCTORY

Section 111 (a) of the Revenue Act of 1938 (Appendix, *infra*) provides in part that the gain from the sale of property shall be the excess of the amount realized therefrom over the adjusted basis provided in Section 113 (b) (Appendix, *infra*) for determining gain. Section 113 (b) requires an adjustment of the unadjusted basis of property as defined in Section 113 (a) (Appendix, *infra*). Therefore, the first step in determining the amount of gain realized by the taxpayer is to ascertain the unadjusted basis of the property within the meaning of Section 113 (a), and the second step is to determine the ad-

justed basis within the meaning of Section 113 (b). The third and last step is to ascertain the amount realized from the sale of the property within the meaning of Section 111 (a), which in turn is defined in Section 111 (b) as the sum of any money received plus the fair market value of the property (other than money) received.

I. UNADJUSTED BASIS

The property in question consisted of an apartment house and the land on which it stood, which the taxpayer acquired as sole devisee under the will of her husband who died in 1932. For the purpose of the federal estate tax, the property was appraised as of the date of his death at a value of $262,042.50. The unadjusted basis applicable here is defined by Section 113 (a) (5), which provides that the basis of property acquired by bequest, devise, or inheritance "shall be the fair market value of such property at the time of such acquisition." Article 113 (a) (5)-1 of Treasury Regulations 101 (Appendix, *infra*) provides that the time of the acquisition of such property is the death of the decedent, and that the value of property as of the date of the death of the decedent as appraised for the purpose of the federal estate tax shall be deemed to be its fair market value at the time of the death of the decedent.

In regard to the unadjusted basis the principal controversy is whether the word "property" in

the statute and Regulations means the physical thing, the apartment house, or the taxpayer's net cash interest in the apartment house. The value of the apartment house was $262,042.50. (R. 36.) At the time of the decedent's death, the property was subject to a mortgage in the amount of $255,000 principal and $7,042.50 accrued interest, or an aggregate sum of $262,042.50, which meant that the taxpayer had a net cash interest in the property on the date of her husband's death of zero. (R. 36.) This Court has held that the words of a statute are to be interpreted in their usual, ordinary and everyday meaning; and that this rule applies to taxing acts. *Old Colony R. Co.* v. *Commissioner,* 284 U. S. 552, 560–561. "Property" ordinarily connotes ownership (*Legal Tender Cases,* 79 U. S. 457, 551), or the right to possess, use and dispose of the physical thing (*United States* v. *General Motors Corp.,* 323 U. S. 373, 377–378). The statute has been consistently so construed.

The point was squarely decided more than ten years ago in *City Bank Farmers Trust Co.* v. *Bowers,* 68 F. 2d 909 (C. C. A. 2d), certiorari denied, 292 U. S. 644. That case involved an estate tax case where the decedent's securities amounting to $1,049,000 had been pledged with a bank to secure loans in the sum of $557,000. In assessing the tax the Commissioner included in the gross estate the total value of the pledged

securities instead of only the surplus after deducting the loans. The estate contended that the statute, properly interpreted, meant to include in the gross estate only the excess of the pledged securities over the amount of the obligation. This contention was rejected in language which is equally pertinent here. The court said (p. 913):

> The last question is whether the pledged securities should be excluded from the gross estate up to the amount of the loans. The statute, section 403 (a) (1), plainly meant the opposite; among the deductions allowed were "unpaid mortgages," an impossible item unless the whole value of the mortgaged property is to be included in the gross estate under section 402 (a), 40 Stat. 1097, as an "interest * * * subject to the payment of the charges against his estate." The regulations under the Act of 1918 (article 15, Regulations 37), specifically so provided; and their successors as well. Section 402 (a) was reenacted in 1921 and 1924 without change, though under a different section number; it is most unlikely that a contrary intent should have escaped expression for so long. * * *.

Moreover, the statute refers specifically to the situs of the physical property. Section 303 (a) (1) of the Revenue Act of 1926, c. 27, 44 Stat. 9, allows a deduction for unpaid mortgages upon property "except in the case of a resident decedent, where such property is not situated in the

United States." The quoted provision came into the law in the Revenue Act of 1921, c. 136, Sec. 403 (a) (1), 42 Stat. 227, after the Attorney General had ruled, 31 Op. A. G. 287 (1918), that under an earlier Act real estate located outside of the United States, belonging to a resident of the United States at the time of his death, was not to be included in determining the value of the gross estate. S. Rep. No. 275, 67th Cong., 1st Sess., p. 24. This seems clearly to negative the taxpayer's contention (Br. 36) that the gross estate includes only the decedent's equity in mortgaged property.

In this case, notwithstanding the mortgage, the taxpayer was the sole owner of the entire property and she alone had the right to possess, use and dispose of it. She collected the rents and paid the operating expenses. (R. 36.) She claimed and was allowed depreciation by the Commissioner on the basis of the full value of the apartment house without any reduction on account of the mortgage. (R. 37.)[1] She paid interest on the mortgage while she was in possession of the property (R. 36) and claimed and was allowed deductions for interest by the Commissioner (R. 37)

[1] The Treasury has consistently allowed taxpayers who acquire real estate by bequest subject to a mortgage to take depreciation on the basis of the full value of the property without any reduction on account of the mortgage.

just as though the mortgage debt were her debt.[2] She reported the rentals from the apartment house as gross income and claimed deductions for the operating expenses of the property. (R. 37.) She paid taxes on the property, and claimed deductions in income tax returns on that account.[3] When she sold the property in the taxable year she conveyed the physical property itself, as shown by the deed of sale. (R. 32.)

In fact, the Tax Court decided that the taxpayer used the property in her trade or business, in passing upon the question whether the apartment house was a capital asset within the meaning of Section 117 of the Revenue Act of 1938. (R. 44.) This part of the Tax Court's decision cannot be reconciled with its conclusion in regard to the unadjusted basis, because in its discussion in regard to Section 117, the Tax Court used the

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[2] This was in accordance with Treasury Regulations of long standing, which treated her as though she were directly liable on the mortgage and as though the mortgage debt were her debt. See Treasury Regulations 45, Art. 124; Treasury Regulation 62, Art. 124; Treasury Regulations 65, Art. 124; Treasury Regulations 69, Art. 124; Treasury Regulations 74, Art. 141; Treasury Regulations 77, Art. 141; Treasury Regulations 86, Art. 23 (b)–1; Treasury Regulations 94, Art. 23 (b)–1; Treasury Regulations 101, Art. 23 (b)–1; Treasury Regulations 103, Sec. 19.23 (b)–1; Treasury Regulations 111, Sec. 29.23 (b)–1.

[3] In general, taxes are deductible only by the person upon whom they are imposed; the vendee of real estate cannot claim a deduction on account of paying the vendor's taxes. See *Magruder* v. *Supplee*, 316 U. S. 394, 396, 398, 399.

word "property" in the sense of the physical thing, whereas in its discussion in regard to unadjusted basis, the Tax Court used "property" in the sense of net cash interest. No reason was given why the word should have different meanings in different sections of the same statute.

If Congress had intended to make the taxpayer's net cash interest on the date of acquisition the basis for determining gain or loss, it probably would have used a term like "cash interest," "equity," "equity of redemption";[1] that would be a more accurate description. If the Tax Court is correct in assuming that the word "property" in the statute refers to equity or net cash interest and the taxpayer sold only an equity in the property, the purchaser from the taxpayer acquired only an equity, so that his basis for gain

[1] See Section 81.38 of Treasury Regulations 105, where reference is made to the equity of redemption (or value of the property, less the indebtedness). This provision of the Regulations first appeared in 1937 pursuant to T. D. 4729, 1937–1 Cum. Bull. 284, 289, amending Article 38 of Treasury Regulations 80 (1934 ed.). The purpose of this provision in the Regulations was to avoid putting the full value of physical property in the gross estate, where the estate could not claim a deduction on account of unpaid mortgages. The statutory provision in regard to deductions on account of unpaid mortgages is limited to cases where they were incurred or contracted bona fide and for an adequate and full consideration in money or money's worth. See also Section 3482 of the Internal Revenue Code, relating to the stamp tax, where the value of any lien or encumbrance is expressly excluded from the value of the property conveyed; and Treasury Regulations 71, Section 113.82.

or loss and for depreciation (see Section 114 (Appendix, *infra*)) is the amount of cash paid for the equity, namely, $3,000.[5]

Moreover, the phraseology of the Regulations confirms the view that the value of the physical thing, rather than the value of taxpayer's net cash interest in the physical thing, was intended. Article 113 (a) (5)–1 of Treasury Regulations 101 provides in subdivision (c) that the basis of property acquired by devise is the value of the property as of the date of the death of the decedent *as appraised* for the purpose of the federal estate tax. This provision of the Treasury Regulations has been in effect since 1918,[6] and the statutory provision to which it refers has been reenacted in substantially the same form in all succeeding Revenue Acts.[7] Therefore the

[5] This would be contrary to the generally prevailing accounting practice. See II Kester, Accounting Theory and Practice (2d ed., 1925) 333; also, 1944 P-H, par. 60,512.

[6] See Treasury Regulations 45, Art. 1562; Treasury Regulations 62, Art. 1563; Treasury Regulations 65, Art. 1594; Treasury Regulations 69, Art. 1594; Treasury Regulations 74, Art. 596; Treasury Regulations 77, Art. 596; Treasury Regulations 86, Art. 113 (a) (5)–1 (c); Treasury Regulations 94, Art. 113(a)(5)–1(c); Treasury Regulations 101, Art. 113 (a) (5)–1 (c); Treasury Regulations 103, Sec. 19.113 (a) (5)–1 (c); Treasury Regulations 111, Sec. 29.113 (a) (5)–1 (c).

[7] Sec. 202 (a) (3) of the Revenue Act of 1921, c. 136, 42 Stat. 227; Sec. 204 (a) (5) of the Revenue Act of 1924, c. 234, 43 Stat. 253; Sec. 204 (a) (5) of the Revenue Act of 1926, c. 27, 44 Stat. 9; Sec. 113 (a) (5) of the Revenue Act of 1928, c. 852, 45 Stat. 791; Sec. 113 (a) (5) of the Revenue Act of 1932, c. 209, 47 Stat. 169; Sec. 113 (a) (5) of the Revenue Act

regulation is entitled to great weight. See *Helvering* v. *Reynolds Co.*, 306 U. S. 110, 114–115; *Merchants Bank* v. *Commissioner*, 320 U. S. 256, 260. The word "appraised" in the regulations suggests that reference was being made to the physical property rather than the equity which is computed from the appraised value.

In recognition of the statutory deduction for mortgages, Article 38 of Treasury Regulations 70 (1929 ed.) provides that the full value of real estate without any deduction for mortgages *must* be included in the gross estate and that the amount of any mortgage may be deducted to the extent that it was incurred or contracted bona fide for an adequate and full consideration in money or money's worth.[8] This regulation was followed by

of 1934, c. 277, 48 Stat. 680; Sec. 113 (a) (5) of the Revenue Act of 1936, c. 690, 49 Stat. 1648; Sec. 113 (a) (5) of the Revenue Act of 1938, c. 289, 52 Stat. 117; Sec. 113 (a) (5) of the Internal Revenue Code, as amended by Sec. 144 of the Revenue Act of 1942, c. 619, 56 Stat. 798.

[8] Under later Treasury Regulations it is mandatory to include the full value of the property subject to the mortgage in the gross estate if the decedent's estate is liable for the amount of the mortgage or indebtedness. But if the decedent's estate is not so liable, only the value of the equity of redemption (or value of the property, less the indebtedness) need be returned as part of the value of the gross estate. See Treasury Regulations 105, Sec. 81.38. This change in the Regulations first appeared in 1937 as T. D. 4729 (see fn. 4, *supra*). Since the decedent in this case died in 1932 and Treasury Regulations 70 (1929 ed.) were not amended, the changed regulation would not seem to be applicable. The record in this case does not clearly indicate whether the decedent assumed liability on the mortgage or not.

the taxpayer as executrix of her husband's estate, because the Tax Court found as a fact that the property was reported at the value of $262,042.50, and the amount due on the mortgage was reported as indebtedness of the estate in the same amount. (R. 36.)

We submit that the word "property" in the statute and the Treasury Regulations should properly be construed as the physical thing and not as the devisee's equity or net cash interest in the property. If we are correct, the unadjusted basis of the property within the meaning of the Treasury Regulations would be $262,042.50. The stipulation of facts shows that of this sum, $55,000 should be allocated to the land and the balance, or $207,042.50, should be allocated to the building. (R. 15.) It may be pointed out that the Tax Court in its opinion paid no attention to the estate tax regulations, although they were relied upon by the Government in its brief. In fact the Tax Court cited no authorities and gave no reasons for its conclusion in regard to the unadjusted basis of the property.

But assuming for the purposes of the argument that the applicable statute and regulation could reasonably be construed as meaning either the value of the physical thing or the taxpayer's net cash interest in the property, it would introduce administrative complication and confusion if the devisee's equity, rather than the value of

the physical thing, were to be treated as the proper basis. While the question involved in this case is the basis for determining gain or loss, the basis for depreciation is necessarily involved because Section 114 of the Revenue Act of 1938 (Appendix, *infra*) provides that the basis for depreciation shall be the same as the basis for gain or loss. Since depreciation is defined in the statute * as exhaustion, wear and tear of property, it could not reasonably be based upon the taxpayer's financial interest in the property, but only upon the value of the physical thing itself. The court below was impressed with the difficulties attendant upon making taxpayer's equity the basis. Suppose, for example, that a taxpayer inherits business property with a fair market value

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* See Section 23 (l) of the Revenue Act of 1938. It may be noted that Congress has treated the life tenant as though he were the absolute owner with respect to the deduction for depreciation; and has provided in the case of property held in trust that the allowable deduction should be apportioned on the basis of the trust income allocable to each beneficiary, in the absence of other provisions in the trust instrument.

The policy seems to be to give the allowance to the person who reports the income and the Commissioner's practice in dealing with mortgaged property promotes that policy. If he had made a distinction between those liable on a mortgage and those not, the full depreciation on literally thousands of pieces of property would not be reflected in any income tax return. There is no authority for taxpayer's suggestion that the mortgagee should have the allowance when the owner is not liable on the mortgage. The mortgagee does not use the property in his business and is accordingly foreclosed from receiving an allowance.

of $90,000, subject to an unassumed mortgage of $40,000, leaving as his equity $50,000; that he depreciates the property on a straight line basis on an estimated life of 20 years; and that he makes an annual $2,000 payment on mortgage principal. In the first year the depreciation on the equity is $2,500. For each successive year the basis will have to be adjusted to reflect the principal payments on the mortgage, and depreciation for previous years will have to be subtracted from the adjusted basis to determine the amount of depreciation allowable for the next succeeding year. Thus for the second year the depreciation will be [($50,000 plus $2,000) − $2,500] divided by 19, or a result of $2,605.26; for the third year $2,716.38; and for the fourth year $2,834.02. The depreciation allowances will increase progressively as the property's estimated life decreases; the nineteenth mortgage principal payment of $2,000 will be entirely depreciated within the twentieth year; and the property's estimated life will have expired before the twentieth payment of $2,000 on mortgage principal can be depreciated.

Moreover, if taxpayer fails to amortize the mortgage for a number of years and then under pressure of threatened foreclosure makes a substantial payment in one year, the consequence will be to compress a large allowance for depreciation within a relatively short period. Should the taxpayer in the above illustration make no

payments on the mortgage until the sixteenth year and then reduce the mortgage by $30,000, he will be entitled, under the taxpayer's contention, to depreciate the $30,000 capital outlay in the remaining five-year life of the property, together with the remaining five years' depreciation of his original equity interest.

Another result would be to set up a zero basis for the property in those cases where the amount of the mortgage equals the fair market value of the property on the critical date (the date of the decedent's death).

In this case the taxpayer claimed and was allowed deductions for depreciation based on the full value of the building on the date of the death of the decedent without any reduction on account of the mortgage. The deductions aggregated $25,500 (R. 37), which approximates the amount of gain determined by the Commissioner (R. 38). This is the first case in which the practice of the Treasury Department in using the full value of the property as the basis both for depreciation and for determining gain or loss has been challenged. It was undoubtedly for this reason that some of the federal tax services adversely criticized the opinion of the Tax Court in this case.[10] The court below said in its opinion (R. 55):

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[10] 1944 P-H, par. 60,512; 1944 C. C. H., pars. 8843–8850, inclusive.

> We cannot doubt, especially in view of the long uniform practice, that the right "basis" for depreciation is the actual value of the buildings.

II. ADJUSTED BASIS

Section 113 (b) (1) (B) of the Revenue Act of 1938 provides that "proper adjustment in respect of the property shall in all cases be made * * * for exhaustion, wear and tear * * * to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws." Moreover, this Court had decided in a case arising under the Revenue Act of 1916, c. 463, 39 Stat. 756, as amended, which did not contain a provision similar to Section 113 (b) (1) (B) requiring adjustment of the basis on account of depreciation and depletion,[11] that the basis for determining gain or loss must be adjusted on account of depreciation and depletion to the extent allowable. *United States* v. *Ludey*, 274 U. S. 295. Incidentally, in the *Ludey* case the taxpayer did not deny that Congress had the power to require that the original cost should be adjusted on account of depreciation and depletion. 274 U. S. 295, 298. As this Court noted in its opinion, unless the statute is construed as

[11] Until 1924, none of the Revenue Acts provided in terms that, in computing the gain from a sale of any property, a deduction shall be made from the original cost on account of depreciation and depletion during the period of operation.

requiring an adjustment of the basis on account of depreciation, the taxpayer would get a double deduction for the loss of the same capital assets.

The taxpayer herein filed income tax returns for the estate of the decedent covering the period January 11 (the date of decedent's death) to December 31, 1932, and for the years 1933, 1934, 1935 and 1936; and income tax returns for the years 1937 and 1938, in which she claimed deductions for depreciation in amounts ranging from $3,200 to $3,900, and aggregating $25,500. (R. 37.) While $25,500 represents the amount of depreciation allowed, the Commissioner determined that the amount allowable was $28,045.10. (R. 38.) Since the parties stipulated that of the sum of $262,042.50, $55,000 should be allocated to the land, and $207,042.50 to the improvements (R. 15), and that the rate of depreciation applicable to the apartment house is two per cent per annum (R. 17), the amount of depreciation, namely, $28,045.10, is merely a matter of simple computation.

Applying Section 113 (b) (1) (B) to the facts of this case, it is necessary to subtract the amount of depreciation allowable, namely, $28,045.10, from the part of the basis allocated to the apartment house building, namely, $207,042.50, in order to obtain the adjusted basis, namely, $178,997.40. (R. 38.) As to the part of the basis allocated to the land, namely, $55,000, there is no need to

adjust the basis because it is not subject to depreciation.

The Tax Court made no finding with respect to tax benefits. Presumably the Tax Court disagreed with the action of the Commissioner in adjusting the basis of the apartment house building by the amount of $28,045.10, only because it determined that the unadjusted basis was zero (R. 43.) The statute is clear and the principle upon which adjustments are made is universally accepted.

III. AMOUNT REALIZED

Section 111 (a) of the Revenue Act of 1938 provides that the gain from the sale or other disposition of property shall be the excess of the "amount realized" therefrom over the adjusted basis provided in Section 113 (b), and the amount realized is defined in Section 111 (b) as the "sum of any money received plus the fair market value of the property (other than money) received."

We have argued that the word "property" in Section 113 and in Article 113 (a) (5)–1 of Treasury Regulations 101 means the physical thing, rather than taxpayer's net cash interest or equity in the property, or the value of the property less the mortgage. Under this construction of the statute, the basis of the land (which is not subject to adjustment on account of depreciation) is $55,000 as shown by the discussion under Point I, *supra*, and the adjusted basis of the building is $178,997.40, as shown under Point II, *supra*. If

the word "property" in Section 113 means the physical thing and the amount of the mortgage is not deducted for the purpose of ascertaining the basis, it would seem to follow that the word "'property" in Section 111 must mean the same thing and that the amount of the mortgage should not be deducted. Only in this way may the symmetry of the statutory scheme be preserved. See *Maguire* v. *Commissioner*, 313 U. S. 1, 8.

If the word "property" in Section 111 means the physical thing, the fair market value of the real estate sold by the taxpayer on November 29, 1938, was the amount of cash paid, $3,000, plus the amount of the mortgage, because the taxpayer's vendee could have owned the property free and clear of the mortgage on the day of the sale by paying $255,000 to the mortgagee.[12] Since the property was in effect sold for $258,000, it is fair to say that the fair market value of the real estate on the day of the sale was $258,000. See *Rogers* v. *Helvering*, 107 F. 2d 394, 396 (C. C. A. 2d); *Robertson* v. *Routzahn*, 75 F. 2d 537, 539 (C. C. A. 6th); *New York* v. *Sage*, 239 U. S. 57, 61.

Assuming that $258,000 was the fair market value of the real estate, that the land and building are what was sold, rather than taxpayer's

[12] We may disregard for tax purposes the amount of outstanding interest, taxes, etc., because they were deductible from gross income or from the proceeds of sale.

equity in the property and that the basis included the value of the mortgage, it would be absurd to say that the taxpayer realized only $3,000 gross, or $2,500 net, from the sale. It would mean that the taxpayer would suffer a loss of $54,471.15[13] on the sale of the land, and a loss of $177,026.25,[14] on the sale of the building, although she concedes, and the Tax Court decided, that she realized a gain of at least $2,500. Furthermore, it would mean that the purchaser from the taxpayer has a basis for depreciation, as well as for gain or loss, of only $3,000, which is contrary to the generally prevailing accounting

[13] Since the basis is $55,000 and the total amount realized for the land and building would be $2,500 and the parties stipulated that the proportion of the selling price allocable to the land is $\frac{5,447,115}{25,750,000}$ (R. 17), the amount of the selling price allocated to the land would be $528.85. The excess of the basis, $55,000, over the part of the selling price allocable to the land, $528.85, represents a loss on the transaction in the amount of $54,471.15. Since the land is a capital asset under Section 117 and it was held for more than 24 months, only one-half of this amount would be recognized as a deductible loss.

[14] Since the adjusted basis for the building is $178,997.40 and the total amount realized for the land and building would be $2,500 and the parties stipulated that the proportion of the selling price allocable to the building is $\frac{20,302,885}{25,750,000}$ (R. 17), the amount of the selling price allocated to the building would be $1,971.15. The excess of the basis, $178,997.40, over the part of the selling price allocable to the building, $1,971.15, represents a loss of $177,026.25. Since the building is not a capital asset under Section 117, the entire loss would be deductible on the sale of the building.

practice. See fn. 5, *supra*, p. 16. The only way in which a reasonable result can be reached is to add the principal amount of the mortgage to the amount of cash received. See *Estate of Ebert* v. *Commissioner*, 37 B. T. A. 186, which the Tax Court failed to distinguish in its opinion in the instant case.

Perhaps it is sufficient to say that the amount of the mortgage must be included in the computation of the "amount realized" because the amount of the mortgage is included in the basis. Thus its inclusion in the amount realized can be justified solely on the ground that that is a condition for permitting the taxpayer to include it in the basis. The taxpayer contends that the amount of the mortgage should be disregarded both in the basis and in the amount realized. She does not contend that if it is included in the basis it should nevertheless be excluded from the amount realized. It is implicit in her argument, and we think there can be no doubt, that there must be similar treatment at both ends of the transaction. The Regulations provide that whatever basis is used for estate tax purposes must similarly be used as the basis by the devisee. Accordingly, since we think we have established that Congress intended that the amount of the mortgage should be reflected in the value of the property for estate tax purposes, it should follow that the amount of the mortgage must be included in the amount realized.

The Tax Court said in its opinion that if the taxpayer had assumed liability for the payment of the mortgage debt and her vendee had in turn assumed taxpayer's liability, such assumption by the vendee would be the equivalent of the receipt of "money" by the taxpayer to the extent of the amount of the liability so assumed. (R. 41.) While the taxpayer did not assume liability on the mortgage, she held the apartment house subject to the conditions and covenants of the mortgage. She was the owner for all purposes; she had all the income; she managed it; she sold it and the increase in value went to her. The mortgagee (the bank), on the other hand, was nothing more than a preferred creditor, even though the taxpayer was not liable on the debt. While it is true that the mortgagee had recourse only to the property, it was a creditor nonetheless. The taxpayer paid the bank interest on the mortgage, and by paying $2,500 in back interest she obtained from the bank a reduction in the interest rate to four percent (R. 25–26).

When the taxpayer sold the property subject to the mortgage, she secured a release from a charge upon her property just as though the purchaser had paid her the full price on condition that before he took title the lien should be cleared.[15] Therefore she

[15] The same is true of a gift. Since the release similarly may be considered as received by a donor of real estate subject to a mortgage, it is not surprising that the value of the gift is only the amount of the donor's equity. Taxpayer's

received property other than money when she sold the property subject to the mortgage and the fair market value of the property was the principal amount of the mortgage, namely, $255,000. In this connection the court below said (R. 55–56):

> She insists, however, that because she was not liable, the lien should not be considered as an equivalent. But the lien of a mortgage does not make the mortgagee a co-tenant; the mortgagor is the owner for all purposes; indeed that is why the "gage" is "mort," as distinguished from a "vivum vadium." *Kortright* v. *Cady*, 21 N. Y. 343, 344. He has all the income from the property; he manages it; he may sell it; any increase in its value goes to him; any decrease falls on him, until the value goes below the amount of the lien. The mortgagee is a creditor, and in effect nothing more than a preferred creditor, even though the mortgagor is not liable for the debt. He is not the less a creditor because he has recourse only to the land, unless we are to deny the term to one who may levy upon only a part of his debtor's assets. When therefore upon a sale the mortgagor makes an allowance to the vendee of the amount of the lien, he secures a release from a charge upon his property quite as though the vendee had paid him the full price on con-

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argument (Br. 37–38) ignores the fact that in computing both estate and gift taxes the amount of the mortgage is ultimately excluded.

dition that before he took title the lien should be cleared, or as though it were a condition upon the sale of Whiteacre that the vendee should clear the vendor's Blackacre of a mortgage. In neither case would anyone question the conclusion that the vendor had received "property (other than money)"; yet the effect is precisely the same of the transaction at bar.

There is another way of illustrating that the taxpayer realized a substantial gain upon the sale of the apartment house, although the actual cash received was only $3,000 gross or $2,500 net. While the taxpayer sold the same apartment house which she inherited from her husband about seven years earlier, seven years of the useful life of the apartment house had been used up in the meantime. Assume that the apartment house building was worth about $200,000 when the taxpayer acquired it and that its useful life was 50 years; it might be said to consist of 50 units of $4,000 each. When the taxpayer sold it, it consisted of only 43 units of $4,000 each, because seven of those units had been used up. Therefore, even though the taxpayer sold the building for the same amount as the value at the time she acquired it seven years earlier, she would nevertheless have realized a gain of $28,000. As a matter of fact, the portion of the selling price allocated to the building by stipulation of the parties was about $4,000 less than the portion

of the basis allocated to the building (R. 38), so that the net gain on the building was about $24,000.

It may be noted that in recent income tax legislation, Congress has made no distinction for basis purposes between the acquisition of property subject to a liability and the assumption of liability. See Section 213 (d) of the Revenue Act of 1939, c. 247, 53 Stat. 862, amending Section 113 (a) (6) of the Internal Revenue Code. The Treasury Regulations relating to installment sales have provided that no distinction shall be drawn between cases where property is taken subject to a mortgage and cases where the mortgage is assumed by the purchaser.[16]

The Tax Court summarily disposed of this regulation on the ground that it was limited to installment sales. That reasoning is obviously too superficial. The Regulations embody a principle which the Tax Court is required to follow, if applicable. The principle has not been limited to installment sales. A taxpayer who is not liable on a mortgage is nevertheless regarded as making the sale upon a foreclosure. *Edward F. C. McLaughlin* v. *Commissioner*, 43 B. T. A. 528.

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[16] See Treasury Regulations 69, Art. 44; Treasury Regulations 74, Art. 352; Treasury Regulations 77, Art. 352; Treasury Regulations 86, Art. 44-2; Treasury Regulations 94, Art. 44-2; Treasury Regulations 101, Art. 44-2; Treasury Regulations 103, Sec. 19.44-2; Treasury Regulations 111, Sec. 29.44-2.

The taxpayer relies upon a recent decision of the Circuit Court of Appeals for the Fifth Circuit, *Hilpert* v. *Commissioner*, 151 F. 2d 929, to show that the amount realized by the taxpayer on the sale should not include the sum of $255,000 representing the unpaid principal of the mortgage. (Br. 29.) In the *Hilpert* case the Tax Court [17] assumed that the taxpayers were personally liable on the mortgage and held that since the redemption of the mortgage by taxpayers' vendee eliminated the indebtedness, the amount of the mortgage must be included in the amount realized. The Circuit Court of Appeals reversed the decision of the Tax Court on the ground that under the law of Florida no debt had been created; that the land was put up purely as a pledge under such circumstances that the courts deem it to be a mortgage, but the mortgagee could not enforce any personal liability against the taxpayers. We think that the decision of the Fifth Circuit was wrong for the reasons given by Judge Hutcheson in his dissenting opinion.[18]

In any event no consideration was given to the critical question here of the proper basis and the need for correlating the basis for depreciation with the computation of gain or loss

[17] 4 T. C. 473.

[18] See also discussion of the case in 59 Harv. L. Rev. 622 (1946); and in 24 Taxes 443 (May 1946).

upon sale. The same is true of the other cases which have drawn distinctions between taxpayers who are and those who are not personally liable on mortgages.

The taxpayer also argues that the result of the decision of the court below is to subject the mortgagor to a tax upon a gain which is out of all proportion to what she received in cash; to a tax which may indeed be greater than the whole cash consideration. (Br. 50, 51.) This reasoning ignores the past advantages which she was entitled to, including allowances for depreciation, which in this case aggregate $25,500.

The taxpayer argues that the reversal of the Tax Court by the court below was a violation of the rule of this Court in *Dobson* v. *Commissioner*, 320 U. S. 489. (Br. 14.) According to our interpretation of the *Dobson* case, the rule does not apply where the Tax Court has made a clear-cut mistake of law. See *Commissioner* v. *Wilcox*, 327 U. S. 404. We believe that the construction of the term "property" in Section 113 (a) (5) and of the term "amount realized" where the taxpayer sells property subject to a mortgage, which she acquired by bequest subject to a mortgage, are questions of law which were properly reviewed by the court below. See Section 1003 (b) of the Revenue Act of 1926, c. 27, 44 Stat. 9.

CONCLUSION

The decision of the court below is correct and should therefore be affirmed.

Respectfully submitted.

GEORGE T. WASHINGTON,
Acting Solicitor General.
SEWALL KEY,
Acting Assistant Attorney General.
J. LOUIS MONARCH,
MORTON K. ROTHSCHILD,
Special Assistants to the Attorney General.

NOVEMBER 1946.

APPENDIX

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of gain or loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(5) *Property transmitted at death.*—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition. * * *

* * * * *

(b) *Adjusted basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined

under subsection (a), adjusted as hereinafter provided.

(1) *General rule.*—Proper adjustment in respect of the property shall in all cases be made—

* * * * *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws. * * *

* * * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

* * * * * *

Treasury Regulations 101, relating to the Revenue Act of 1938:

ART. 113 (a) (5)–1. *Basis of property acquired by bequest, devise, or inheritance.*—* * *

(b) * * *

(1) *General rule.*—Except as prescribed in paragraph (2) the basis of property acquired from a decedent by will or under the law governing the descent and distribution of the property of decedents is the fair market value at the time of such acquisition. Since under the law governing wills and the distribution of the property of decedents, all titles to property acquired by bequest, devise, or inheritance relate back

to the death of the decedent, even though the interest of him who takes the title was, at the date of death of the decedent, legal, equitable, vested, contingent, general, specific, residual, conditional, executory, or otherwise, the time of the acquisition of such property is the death of the decedent. * * *

The purpose of the Act, in prescribing a general uniform basis rule for property acquired by bequest, devise, or inheritance, is, on the one hand, to tax the gain, in respect of such property, to him who realizes it (without regard to the circumstance that at the death of the decedent it may have been quite uncertain whether the taxpayer would take or gain anything); and, on the other hand, not to recognize as gain any element of value solely from the circumstance that the possession or enjoyment of the taxpayer was postponed. Such postponement may be, for example, until the administration of the decedent's estate is completed, until the period of the possession or enjoyment of another has terminated, or until an uncertain event has happened. It is the increase or decrease in the value of property reflected in a sale or other disposition which section 113 (a) (5) recognizes as the measure of gain or loss.

* * * * * *

(c) *Fair market value.*—For the purposes of this article, the value of property as of the date of the death of the decedent as appraised for the purpose of the Federal estate tax or if the property is not appraised as of the date of death of the decedent for such purpose or if the estate is not subject to such tax, its value as ap-

praised as of the date of the death of the decedent for the purpose of State inheritance or transmission taxes, shall be deemed to be its fair market value at the time of the death of the decedent.

* * * * *

(e) *Adjustments to basis.*—In the hands of every person who acquires the property of a decedent (or any estate or interest therein) by bequest, or devise, or inheritance, the basis of the property is always the same,

(1) whether such person be the executor or administrator, the heir, the legatee, the devisee, the trustee of a trust created by the will, or any beneficiary of such trust, and whatever the nature of any such person's interest or estate may be;

(2) whether during or after administration and settlement of the estate of the decedent, during or after the term of any trust under the will, or before or after the distribution by the executor or administrator, or the trustee.

Adjustments to basis required by section 113 (b) are made in accordance with the same principles. * * *

U. S. GOVERNMENT PRINTING OFFICE: 1944

SUPREME COURT OF THE UNITED STATES

No. 68.—October Term, 1946.

Beulah B. Crane, Petitioner, v. Commissioner of Internal Revenue, Respondent.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[April 14, 1947.]

Mr. Chief Justice Vinson delivered the opinion of the Court.

The question here is how a taxpayer who acquires depreciable property subject to an unassumed mortgage, holds it for a period, and finally sells it still so encumbered, must compute her taxable gain.

Petitioner was the sole beneficiary and the executrix of the will of her husband, who died January 11, 1932. He then owned an apartment building and lot subject to a mortgage,[1] which secured a principal debt of $255,000.00 and interest in default of $7,042.50. As of that date, the property was appraised for federal estate tax purposes at a value exactly equal to the total amount of this encumbrance. Shortly after her husband's death, petitioner entered into an agreement with the mortgagee whereby she was to continue to operate the property—collecting the rents, paying for necessary repairs, labor, and other operating expenses, and reserving $200.00 monthly for taxes—and was to remit the net rentals to the mortgagee. This plan was followed for nearly seven years, during which period petitioner reported the gross rentals as income, and claimed and was allowed deductions for taxes and operating expenses paid on the property, for interest paid on the mortgage, and for the physical exhaustion of

[1] The record does not show whether he was personally liable for the debt.

the building. Meanwhile, the arrearage of interest increased to $15,857.71. On November 29, 1938, with the mortgagee threatening foreclosure, petitioner sold to a third party for $3,000.00 cash, subject to the mortgage, and paid $500.00 expenses of sale.

Petitioner reported a taxable gain of $1,250.00. Her theory was that the "property" which she had acquired in 1932 and sold in 1938 was only the equity, or the excess in the value of the apartment building and lot over the amount of the mortgage. This equity was of zero value when she acquired it. No depreciation could be taken on a zero value.[2] Neither she nor her vendee ever assumed the mortgage, so, when she sold the equity, the amount she realized on the sale was the net cash received, or $2,500.00. This sum less the zero basis constituted her gain, of which she reported half as taxable on the assumption that the entire property was a "capital asset".[3]

The Commissioner, however, determined that petitioner realized a net taxable gain of $23,767.03. His theory was that the "property" acquired and sold was not the equity, as petitioner claimed, but rather the physical property itself, or the owner's rights to possess, use, and dispose of it, undiminished by the mortgage. The original basis thereof was $262,042.50, its appraised value in 1932. Of this value $55,000.00 was allocable to land and $207,042.50 to building.[4] During the period that petitioner held the

[2] This position is, of course, inconsistent with her practice in claiming such deductions in each of the years the property was held. The deductions so claimed and allowed by the Commissioner were in the total amount of $25,500.00.

[3] See § 117 (a) (b), Revenue Act of 1938, c. 289, 52 Stat. 447. Under this provision only 50% of the gain realized on the sale of a "capital asset" need be taken into account, if the property had been held more than two years.

[4] The parties stipulated as to the relative parts of the 1932 appraised value and of the 1938 sales price which were allocable to land and building.

property, there was an allowable depreciation of $28,045.10 on the building;[5] so that the adjusted basis of the building at the time of sale was $178,997.40. The amount realized on the sale was said to include not only the $2,500.00 net cash receipts, but also the principal amount[6] of the mortgage subject to which the property was sold, both totaling $257,500.00. The selling price was allocable in the proportion, $54,471.15 to the land and $203,028.85 to the building.[7] The Commissioner agreed that the land was a "capital asset", but thought that the building was not.[8] Thus, he determined that petitioner sustained a capital loss of $528.85 on the land, of which 50% or $264.42 was taken into account, and an ordinary gain of $24,031.45 on the building, or a net taxable gain as indicated.

The Tax Court agreed with the Commissioner that the building was not a "capital asset." In all other respects it adopted petitioner's contentions, and expunged the deficiency.[9] Petitioner did not appeal from the part of the ruling adverse to her, and these questions are no longer at issue. On the Commissioner's appeal, the Circuit Court

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[5] The parties stipulated that the rate of depreciation applicable to the building was 2% per annum.

[6] The Commissioner explains that only the principal amount, rather than the total present debt secured by the mortgage, was deemed to be a measure of the amount realized, because the difference was attributable to interest due, a deductible item.

[7] See *supra*, note 4.

[8] See § 117 (a) (1), Revenue Act of 1938, *supra*.

[9] 3 T. C. 585. The Court held that the building was not a "capital asset" within the meaning of § 117 (a) and that the entire gain on the building had to be taken into account under § 117 (b), because it found that the building was of a character subject to physical exhaustion and that petitioner had used it in her trade or business.

But because the Court accepted petitioner's theory that the entire property had a zero basis, it held that she was not entitled to the 1938 depreciation deduction on the building which she had inconsistently claimed.

For these reasons, it did not expunge the deficiency in its entirety.

of Appeals reversed, one judge dissenting.[10] We granted certiorari because of the importance of the questions raised as to the proper construction of the gain and loss provisions of the Internal Revenue Code.[11]

The 1938 Act,[12] § 111 (a), defines the gain from "the sale or other disposition of property" as "the excess of the amount realized therefrom over the adjusted basis provided in § 113 (b). . . ." It proceeds, § 111 (b), to define "the amount realized from the sale or other disposition of property" as "the sum of any money received plus the fair market value of the property (other than money) received." Further, in § 113 (b), the "adjusted basis for determining the gain or loss from the sale or other disposition of property" is declared to be "the basis under subsection (a), adjusted . . . [(1) (B)] . . . for exhaustion, wear and tear, obsolescence, amortization . . . to the extent allowed (but not less than the amount allowable). . . ." The basis under subsection (a) "if the property was acquired by . . . devise . . . or by the decedent's estate from the decedent", § 113 (a) (5), is "the fair market value of such property at the time of such acquisition."

Logically, the first step under this scheme is to determine the unadjusted basis of the property, under § 113 (a) (5), and the dispute in this case is as to the construction to be given the term "property". If "property", as used in that provision, means the same thing as "equity", it would necessarily follow that the basis of petitioner's property was zero, as she contends. If, on the contrary, it means the land and building themselves, or the owner's legal rights in them, undiminished by the mortgage, the basis was $262,042.50.

[10] 153 F. 2d 504.

[11] —— U. S. ——.

[12] All subsequent references to a revenue act are to this Act unless otherwise indicated. The relevant parts of the gain and loss provisions of the Act and Code are identical.

We think that the reasons for favoring one of the latter constructions are of overwhelming weight. In the first place, the words of statutes—including revenue acts—should be interpreted where possible in their ordinary, everyday senses.[13] The only relevant definitions of "property" to be found in the principal standard dictionaries [14] are the two favored by the Commissioner, *i. e.*, either that "property" is the physical thing which is a subject of ownership, or that it is the aggregate of the owner's rights to control and dispose of that thing. "Equity" is not given as a synonym, nor do either of the foregoing definitions suggest that it could be correctly so used. Indeed, "equity" is defined as "the value of a property . . . above the total of the liens. . . ." [15] The contradistinction could hardly be more pointed. Strong countervailing considerations would be required to support a contention that Congress, in using the word "property", meant "equity", or that we should impute to it the intent to convey that meaning.[16]

In the second place, the Commissioner's position has the approval of the administrative construction of § 113 (a) (5). With respect to the valuation of property under that section, Reg. 101, Art. 113 (a) (5)–1, promulgated under the 1938 Act, provided that "the value of property as of the date of the death of the decedent as appraised for the purpose of the federal estate tax . . . shall be deemed to be its fair market value. . . ." The land and building here involved were so appraised in 1932, and their appraised value—$262,042.50—was reported by petitioner as part of the gross estate. This was in accord-

[13] *Old Colony R. Co.* v. *Commissioner*, 284 U. S. 552, 560.

[14] See Webster's New International Dictionary, Unabridged, 2d Ed.; Funk & Wagnalls' New Standard Dictionary; Oxford English Dictionary.

[15] See Webster's New International Dictionary, *supra*.

[16] *Crooks* v. *Harrelson*, 282 U. S. 55, 59.

ance with the estate tax law [17] and regulations,[18] which had always required that the value of decedent's property, undiminished by liens, be so appraised and returned, and that mortgages be separately deducted in computing the net estate.[19] As the quoted provision of the Regulations has been in effect since 1918,[20] and as the relevant statutory provision has been repeatedly reenacted since then in substantially the same form,[21] the former may itself now be considered to have the force of law.[22]

Moreover, in the many instances in other parts of the Act in which Congress has used the word "property", or expressed the idea of "property" or "equity", we find no instances of a misuse of either word or of a confusion of the ideas.[23] In some parts of the Act other than the gain and loss sections, we find "property" where it is unmistakably used in its ordinary sense.[24] On the other hand,

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[17] See §§ 202 and 203 (a) (1), Revenue Act of 1916; §§ 402 and 403 (a) (1), Revenue Acts of 1918 and 1921; §§ 302, 303 (a) (1), Revenue Acts of 1924 and 1926; § 805, Revenue Act of 1932.

[18] See Reg. 37, Arts. 13, 14, and 47; Reg. 63, Arts. 12, 13, and 41; Reg. 68, Arts. 11, 13, and 38; Reg. 70, Arts. 11, 13, and 38; Reg. 80, Arts. 11, 13, and 38.

[19] See *City Bank Farmers Trust Co.* v. *Bowers*, 68 F. 2d 909, cert. denied, 292 U. S. 644; *Rodiek* v. *Helvering*, 87 F. 2d 328; *Adriance* v. *Higgins*, 113 F. 2d 1013.

[20] See also Reg. 45, Art. 1562; Reg. 62, Art. 1563; Reg. 65, Art. 1594; Reg. 69, Art. 1594; Reg. 74, Art. 596; Reg. 77, Art. 596; Reg. 86, Art. 113 (a) (5)–1 (c); Reg. 94, Art. 113 (a) (5)–1 (c); Reg. 103, § 19.113 (a) (5)–1 (c); Reg. 111, § 29.113 (a) (5)–1 (c).

[21] § 202 (a) (3), Revenue Act of 1921; § 204 (a) (5), Revenue Act of 1924; § 204 (a) (5), Revenue Act of 1926; § 113 (a) (5), Revenue Act of 1928; § 113 (a) (5), Revenue Act of 1932; § 113 (a) (5), Revenue Act of 1934; § 113 (a) (5), Revenue Act of 1936; § 113 (a) (5), Revenue Act of 1938; § 113 (a) (5), Internal Revenue Code.

[22] *Helvering* v. *Reynolds Co.*, 306 U. S. 110, 114.

[23] Cf. *Helvering* v. *Stockholms Bank*, 293 U. S. 84, 87.

[24] Sec. 23 (a) (1) permits the deduction from gross income of "rentals . . . required to be made as a condition to the continued

where either Congress or the Treasury intended to convey the meaning of "equity," it did so by the use of appropriate language.[25]

A further reason why the word "property" in § 113 (a) should not be construed to mean "equity" is the bearing such construction would have on the allowance of deductions for depreciation and on the collateral adjustments of basis.

Section 23 (l) permits deduction from gross income of "a reasonable allowance for the exhaustion, wear and tear of property. . . ." Sections 23 (n) and 114 (a) declare that the "basis upon which exhaustion, wear and tear . . . are to be allowed" is the basis "provided in Sec. 113 (b) for the purpose of determining the gain upon the sale" of the property, which is the § 113 (a) basis "adjusted . . . for exhaustion, wear and tear . . . to the extent allowed (but not less than the amount allowable). . . ."

Under these provisions, if the mortgagor's equity were the § 113 (a) basis, it would also be the original basis from which depreciation allowances are deducted. If it is, and if the amount of the annual allowances were to be computed on that value, as would then seem to be required,[26]

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use . . . for purposes of the trade or business, of *property* . . . in which he [the taxpayer] has no *equity*."

Sec. 23 (l) permits the deduction from gross income of "a reasonable allowance for the exhaustion, wear and tear of *property* used in the trade or business. . . ."

See also § 303 (a) (1), Revenue Act of 1926, c. 27, 44 Stat. 9; § 805, Revenue Act of 1932, c. 209, 47 Stat. 280.

[25] See § 23 (a) (1), *supra*, note 24; § 805, Revenue Act of 1932, *supra*, note 24; § 3482, I. R. C.; Reg. 105, § 81.38. This provision of the Regulations, first appearing in 1937, T. D. 4729, 1937-1 Cum. Bull. 284, 289, permitted estates which were not liable on mortgages applicable to certain of decedent's property to return "only the value of the equity of redemption (or value of the property, less the indebtedness). . . ."

[26] Secs. 23 (n) and 114 (a), in defining the "basis upon which" depreciation is "to be allowed", do not distinguish between basis as the

they will represent only a fraction of the cost of the corresponding physical exhaustion, and any recoupment by the mortgagor of the remainder of that cost can be effected only by the reduction of his taxable gain in the year of sale.[27] If, however, the amount of the annual allowances were to be computed on the value of the property, and then deducted from an equity basis, we would in some instances have to accept deductions from a minus basis or deny deductions altogether.[28] The Commissioner also argues that taking the mortgagor's equity as the § 113 (a) basis would require the basis to be changed with each payment on the mortgage,[29] and that the attendant problem of repeatedly recomputing basis and annual allowances would be a tremendous accounting burden on both the Commissioner and the taxpayer. Moreover, the mortgagor would acquire control over the timing of his depreciation allowances.

Thus it appears that the applicable provisions of the Act expressly preclude an equity basis, and the use of it is contrary to certain implicit principles of income tax depreciation, and entails very great administrative difficul-

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minuend from which the allowances are to be deducted, and as the dividend from which the amount of the allowance is to be computed. The Regulations indicate that the basis of property is the same for both purposes. Reg. 101, Art. 23 (l)–4, 5.

[27] This is contrary to Treasury practice, and to Reg. 101, Art. 23 (l)–5, which provides in part:

"The capital sum to be recovered shall be charged off over the useful life of the property, either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production."

See *Detroit Edison Co.* v. *Commissioner*, 319 U. S. 98, 101.

[28] So long as the mortgagor remains in possession, the mortgagee can not take depreciation deductions, even if he is the one who actually sustains the capital loss, as § 23 (l) allows them only on property "used in the trade or business."

[29] Sec. 113 (b) (1) (A) requires adjustment of basis "for expenditures . . . properly chargeable to capital account. . . ."

ties.[20] It may be added that the Treasury has never furnished a guide through the maze of problems that arise in connection with depreciating an equity basis, but, on the contrary, has consistently permitted the amount of depreciation allowances to be computed on the full value of the property, and subtracted from it as a basis. Surely, Congress' long-continued acceptance of this situation gives it full legislative endorsement.[21]

We conclude that the proper basis under § 113 (a) (5) is the value of the property, undiminished by mortgages thereon, and that the correct basis here was $262,042.50. The next step is to ascertain what adjustments are required under § 113 (b). As the depreciation rate was stipulated, the only question at this point is whether the Commissioner was warranted in making any depreciation adjustments whatsoever.

Section 113 (b) (1) (B) provides that "proper adjustment in respect of the property *shall in all cases be made* . . . for exhaustion, wear and tear . . . to the extent allowed (but not less than the amount allowable). . . ." The Tax Court found on adequate evidence that the apartment house was property of a kind subject to physical exhaustion, that it was used in taxpayer's trade or business, and consequently that the taxpayer would have been entitled to a depreciation allowance under § 23 (l), except that, in the opinion of that Court, the basis of the property was zero, and it was thought that depreciation could not be taken on a zero basis. As we have just decided that the correct basis of the property was not

[20] Obviously we are not considering a situation in which a taxpayer has acquired and sold an equity of redemption only, *i. e.*, a right to redeem the property without a right to present possession. In that situation, the right to redeem would itself be the aggregate of the taxpayer's rights and would undoubtedly constitute 'property' within the meaning of § 113 (a). No depreciation problems would arise. See note 28.

[21] See note 22.

zero, but $262,042.50, we avoid this difficulty, and conclude that an adjustment should be made as the Commissioner determined.

Petitioner urges to the contrary that she was not entitled to depreciation deductions, whatever the basis of the property, because the law allows them only to one who actually bears the capital loss,[32] and here the loss was not hers but the mortgagee's. We do not see, however, that she has established her factual premise. There was no finding of the Tax Court to that effect, nor to the effect that the value of the property was ever less than the amount of the lien. Nor was there evidence in the record, or any indication that petitioner could produce evidence, that this was so. The facts that the value of the property was only equal to the lien in 1932 and that during the next six and one-half years the physical condition of the building deteriorated and the amount of the lien increased, are entirely inconclusive, particularly in the light of the buyer's willingness in 1938 to take subject to the increased lien and pay a substantial amount of cash to boot. Whatever may be the rule as to allowing depreciation to a mortgagor on property in his possession which is subject to an unassumed mortgage and clearly worth less than the lien, we are not faced with that problem and see no reason to decide it now.

At last we come to the problem of determining the "amount realized" on the 1938 sale. Section 111 (b), it will be recalled, defines the "amount realized" from "the sale . . . of property" as "the sum of any money received plus the fair market value of the property (other than money) received," and § 111 (a) defines the gain on "the sale . . . of property" as the excess of the amount realized over the basis. Quite obviously, the word "property", used here with reference to a sale, must mean "property" in

[32] See *Helvering* v. *Lazarus & Co.*, 308 U. S. 252; *Duffy* v. *Central R. Co.*, 268 U. S. 55, 61.

the same ordinary sense intended by the use of the word with reference to acquisition and depreciation in § 113, both for certain of the reasons stated heretofore in discussing its meaning in § 113, and also because the functional relation of the two sections requires that the word mean the same in one section that it does in the other. If the "property" to be valued on the date of acquisition is the property free of liens, the "property" to be priced on a subsequent sale must be the same thing.[33]

Starting from this point, we could not accept petitioner's contention that the $2,500.00 net cash was all she realized on the sale except on the absurdity that she sold a quarter-of-a-million dollar property for roughly one per cent of its value, and took a 99 per cent loss. Actually, petitioner does not urge this. She argues, conversely, that because only $2,500.00 was realized on the sale, the "property" sold must have been the equity only, and that consequently we are forced to accept her contention as to the meaning of "property" in § 113. We adhere, however, to what we have already said on the meaning of "property", and we find that the absurdity is avoided by our conclusion that the amount of the mortgage is properly included in the "amount realized" on the sale.

Petitioner concedes that if she had been personally liable on the mortgage and the purchaser had either paid or assumed it, the amount so paid or assumed would be considered a part of the "amount realized" within the meaning of § 111 (b).[34] The cases so deciding have al-

[33] See *Maguire* v. *Commissioner*, 313 U. S. 1, 8.

We are not troubled by petitioner's argument that her contract of sale expressly provided for the conveyance of the equity only. She actually conveyed title to the property, and the buyer took the same property that petitioner had acquired in 1932 and used in her trade or business until its sale.

[34] *United States* v. *Hendler*, 303 U. S. 564; *Brons Hotels, Inc.*, 34 B. T. A. 376; *Walter F. Haase*, 37 B. T. A. 948. See *Douglas* v. *Willcuts*, 296 U. S. 1, 8.

ready repudiated the notion that there must be an actual receipt by the seller himself of "money" or "other property", in their narrowest senses. It was thought to be decisive that one section of the Act must be construed so as not to defeat the intention of another or to frustrate the Act as a whole,[35] and that the taxpayer was the "beneficiary" of the payment in "as real and substantial [a sense] as if the money had been paid it and then paid over by it to its creditors." [36]

Both these points apply to this case. The first has been mentioned already. As for the second, we think that a mortgagor, not personally liable on the debt, who sells the property subject to the mortgage and for additional consideration, realizes a benefit in the amount of the mortgage as well as the boot.[37] If a purchaser pays boot, it is immaterial as to our problem whether the mortgagor is also to receive money from the purchaser to discharge the mortgage prior to sale, or whether he is merely to transfer subject to the mortgage—it may make a difference to the purchaser and to the mortgagee, but not to the mortgagor. Or put in another way, we are no more concerned with whether the mortgagor is, strictly speaking, a debtor on the mortgage, than we are with whether the benefit to him is, strictly speaking, a receipt of money or property. We are rather concerned with the reality that an owner of property, mortgaged at a figure less than that at which the property will sell, must and will treat the conditions of the mortgage exactly as if they were

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[35] See *Brons Hotels, Inc., supra*, 34 B. T. A. at 381.

[36] See *United States* v. *Hendler*, *supra*, 303 U. S. at 566.

[37] Obviously, if the value of the property is less than the amount of the mortgage, a mortgagor who is not personally liable cannot realize a benefit equal to the mortgage. Consequently, a different problem might be encountered where a mortgagor abandoned the property or transferred it subject to the mortgage without receiving boot. That is not this case.

his personal obligations.[38] If he transfers subject to the mortgage, the benefit to him is as real and substantial as if the mortgage were discharged, or as if a personal debt in an equal amount had been assumed by another.

Therefore we conclude that the Commissioner was right in determining that petitioner realized $257,500.00 on the sale of this property.

The Tax Court's contrary determinations, that "property", as used in § 113 (a) and related sections, means "equity", and that the amount of a mortgage subject to which property is sold is not the measure of a benefit realized, within the meaning of § 111 (b), announced rules of general applicability on clear-cut questions of law.[39] The Circuit Court of Appeals therefore had jurisdiction to review them.[40]

Petitioner contends that the result we have reached taxes her on what is not income within the meaning of the Sixteenth Amendment. If this is because only the direct receipt of cash is thought to be income in the constitutional sense, her contention is wholly without merit.[41] If it is because the entire transaction is thought to have been "by all dictates of common-sense . . . a ruinous disaster", as it was termed in her brief, we disagree with her premise. She was entitled to depreciation deductions for a period of nearly seven years, and she actually took them in almost the allowable amount. The crux of this case, really, is

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[38] For instance, this petitioner returned the gross rentals as her own income, and out of them paid interest on the mortgage, on which she claimed and was allowed deductions. See Reg. 77, Art. 141; Reg. 86, Art. 23 (b)-1; Reg. 94, Art. 23 (b)-1; Reg. 101, Art. 23 (b)-1.

[39] See *Commissioner* v. *Wilcox*, 327 U. S. 404, 410; *Trust of Bingham* v. *Commissioner*, 325 U. S. 365, 369–372. Cf. *John Kelley Co.* v. *Commissioner*, 326 U. S. 521, 527; *Dobson* v. *Commissioner*, 320 U. S. 489.

[40] *Ibid*; see also § 1141 (a) and (c), I. R. C.

[41] *Douglas* v. *Wilcutts*, *supra*, 296 U. S. at 9; *Burnet* v. *Wells*, 289 U. S. 670, 677.

whether the law permits her to exclude allowable deductions from consideration in computing gain.[42] We have already showed that, if it does, the taxpayer can enjoy a double deduction, in effect, on the same loss of assets. The Sixteenth Amendment does not require that result any more than does the Act itself.

Affirmed.

[42] In the course of the argument some reference was made, as by analogy, to a situation in which a taxpayer acquired by devise property subject to a mortgage in an amount greater than the then value of the property, and later transferred it to a third person, still subject to the mortgage, and for a cash boot. Whether or not the difference between the value of the property on acquisition and the amount of the mortgage would in that situation constitute either statutory or constitutional income is a question which is different from the one before us, and which we need not presently answer.

SUPREME COURT OF THE UNITED STATES

No. 68.—October Term, 1946.

Beulah B. Crane, Petitioner, *v.* Commissioner of Internal Revenue, Respondent.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[April 14, 1947.]

Mr. Justice Jackson, dissenting.

The Tax Court concluded that this taxpayer acquired only an equity worth nothing. The mortgage was in default, the mortgage debt was equal to the value of the property, any possession by the taxpayer was forfeited and terminable immediately by foreclosure, and perhaps by a receiver *pendente lite*. Arguments can be advanced to support the theory that the taxpayer received the whole property and thereupon came to owe the whole debt. Likewise it is argued that when she sold she transferred the entire value of the property and received release from the whole debt. But we think these arguments are not so conclusive that it was not within the province of the Tax Court to find that she received an equity which at that time had a zero value. *Dobson* v. *Commissioner*, 320 U. S. 489; *Commissioner* v. *Scottish American Investment Co., Ltd.*, 323 U. S. 119. The taxpayer never became personally liable for the debt, and hence when she sold she was released from no debt. The mortgage debt was simply a subtraction from the value of what she did receive, and from what she sold. The subtraction left her nothing when she acquired it and a small margin when she sold it. She acquired a property right equivalent to an equity of redemption and sold the same thing.

It was the "property" bought and sold as the Tax Court considered it to be under the Revenue Laws. We are not required in this case to decide whether depreciation was properly taken, for there is no issue about it here.

We would reverse the Court of Appeals and sustain the decision of the Tax Court.

MR. JUSTICE FRANKFURTER and MR. JUSTICE DOUGLAS join in this opinion.